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March 6, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Subject: Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

On behalf of SCE Federal Credit Union, I appreciate the opportunity to comment on NCUA's proposed amendments to Part 704.

In our view the proposal raises far more substantial concerns than it provides realistic solutions. There are several provisions that, if enacted as proposed, will make it essentially impossible for corporate credit unions to operate in a viable fashion. Further, many of these provisions will have harmful effects on natural person credit unions and, ultimately, their members.

We join with the California and Nevada Credit Union Leagues, and many other credit union commenters, in urging the Board to withdraw the proposal as drafted so that a more cohesive and feasible set of rules can be crafted. We strongly believe that there should be another round of proposed rulemaking for Part 704—with another 90 day comment period—before issuing final rules to govern corporate credit unions.

Time Period for Capital Ratio Attainment
As drafted. the one year window required by the proposal to attain the risk-based capital ratios (i.e., the 4% Leverage Ratio) will require corporates to bring in new capital or, at a minimum, convert existing MCA to the new PCC during a time when significant issues remain unresolved regarding legacy assets. Due to a lack of sufficient retained earnings at most corporates, and an inability to grow retained earnings at a rate required by the proposed rule (see discussion below), member credit unions will likely be asked to contribute approximately 4% of the corporate credit union deposits as perpetual capital within 12 months of the publication date of the final rule.

We are certain that no credit unions, including SCE FCU, will be willing to contribute additional capital in such a short time frame, and in such an uncertain environment. Additionally, as we discuss under the legacy asset section, the Board's proposal does not address legacy assets. This is clearly one more reason that few, if any, credit unions would be willing to contribute capital to any corporate still holding underwater legacy assets. Indeed, some credit unions may decide to pull their deposits from the corporate system as the result of such a precipitous move to achieving a 4% Leverage Ratio via PCC. This, in turn, would lead to liquidity concerns for corporates.

We recommend that the NCUA clarify its intention with respect to the time period for capital ratio attainment. Given the unavoidable reality that credit unions will need longer than one year before they will feel comfortable recapitalizing corporates, we urge the NCUA to recognize that: (a) some kind of financing or capital note (equivalent to 4% of a corporate's balance sheet) will be required to meet corporates' operational needs; and (b) the proposal's time period for attaining the risk-based capital ratios must be extended to at least three years.

Retained Earnings Growth Model
We take issue with NCUA's assumptions regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), and are of the opinion that it does not represent a reasonable or attainable mix.

We believe the proposed model violates principles of concentration risk, represents too much exposure, and is far-removed from attainable, real-world results. Further, the model appears to provide little opportunity for diversification, which will make retained earnings growth that much more difficult to realize. Such a business model is unreasonable and counterproductive and, ultimately, will be crippling to the corporate network. For example, without an ability to generate earnings from investment risk, corporates will not be able to keep payment system fees down, forcing a move from a cooperative payment system pricing model to a market-based, for-profit model. This will have a pronounced effect on natural person credit unions, as they will be saddled with much higher fees (we have seen analysis which indicates a potential increase in fees of 2 to 3 times current levels), as well as the possibility of obtaining and maintaining new payment services relationships.

We would like the NCUA to provide independent, third-party "proof of concept" validation of the Agency's business model presented in this proposal or any alternative proposal. A credible assessment will test the assumptions and ultimate viability of the proposed business model.

Average-Life NEV Testing
We are very troubled by analyses which indicate that there is no combination of assets—with a two-year average life and limited extension risk—that could generate sufficient margin to attract funding *and* pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a corporate by these tests would not allow corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. (The 2 year average weighted life limitation will make holding Agency and Private Label Mortgage Backed Securities—the largest sector of potential investments—virtually impossible for corporates.) Any ability to generate a reasonable interest margin in order to build retained earnings will become very dependent upon a lower cost of funds for corporates, which means a lower yield paid to members.

In our view, the proposed spread widening of 300 bps appears to be an over-reaction by the NCUA to a once-in-a-lifetime, completely unique event. Historical analysis indicates that, over the past 15 years, excluding recent events, credit card and auto ABS credit spreads to LIBOR widened to a maximum of approximately 50 bps, and generated a standard deviation of spread volatility of approximately 10 bps.

We believe it would be more realistic to set the credit shock test at 100 bps widening - double the historical average. Even at 100 bps credit shock, a NEV volatility limit of 35 percent decline is needed to accommodate the impact of floating-rate investments carrying the loss to maturity. Therefore, we urge the NCUA to amend this test to a 100 bps credit spread widening and a 35 percent NEV volatility tolerance limit.

Weighted Average Asset Life
This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years and includes loans to members. Such a requirement will have adverse implications for natural person credit unions seeking to fill liquidity needs with term loans from corporates. In order to keep the overall WAL of its portfolio within the two year limit, most of the loans made by a corporate will be limited to shorter-term maturities. For longer-term loans, a corporate will have to substantially increase the rate offered in order to compensate for the impact the longer term will have on its two year WAL test.

The two year proposed limitation will force hundreds of credit unions—in California and Nevada alone—to seek less beneficial, or more expensive, funding from other sources. In addition, many natural person credit unions use longer term borrowings to mitigate interest rate risk. A limitation on borrowings from corporates to two years would take away an important tool for these credit unions.

Therefore, we request the Board to exclude loans from the calculation of weighted average life of the investment portfolio.

Legacy Assets in Corporate Credit Unions
Dealing with investment securities remaining on corporates' books is vital to realizing any lasting, consequential changes to the corporate system. These assets—by some estimates believed to represent as much as $30 billion in eventual losses, or one-third of all natural person credit union net worth—continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions. No investor will invest unless the toxic assets are segregated so that new capital is not at risk.

We strongly urge the NCUA to cooperatively and transparently address the business and regulatory issues associated with these assets so that corporate credit union balance sheets can start with a "clean slate," rather than from a negative position. The NCUA should also address any problem assets that may reside on the balance sheets of corporate credit union service organizations.

Qualifications of Directors
We are of the opinion that a maximum of nine years (as compared to six) provides a more reasonable and useful time for training and developing directors as well as for benefiting from the investment in their development. Extending the term limit to nine years further allows for much needed continuity for a corporate without compromising the benefits that may be realized from bringing on new directors.

Further, we believe that outside directors with investment expertise should be permitted to serve, as long as adequate safeguards are in place to address conflicts of interest between an outside director's professional investment interests and his/her responsibility to preserve the confidential and proprietary interests of a corporate credit union.

Risk-Based Net Worth for Natural Person Credit Unions
We strongly support adoption of risk-based capital among corporate credit unions and natural person credit unions.

Consolidation of Corporate Credit Unions
We believe that corporate consolidation would be beneficial to the system, and that the NCUA should be more open, responsive, and supportive of such consolidation by removing unreasonable impediments and/or resistance to corporate credit union mergers. We

recognize that the current number of corporates is less than ideal with respect to efficiency and effectiveness (e.g., potentially redundant member capital requirements, duplication of expertise, staffing, and infrastructure).
In identifying the "best" business model for corporates in the future, it is worthwhile to contemplate how much stronger and more valuable corporate credit unions would be to the nation, credit unions, and consumer-members if they adopted an FHLB-type model wherein corporates could raise money from selling bonds with the full faith and credit of the Treasury to support consumer and small business lending.

To summarize, we firmly believe that the Board should forego finalizing the above critical issues in their current proposed form, and should carefully assess all comments and analysis the NCUA receives from commenters regarding the viability and reasonableness of the tests and the two year average weighted life limitation, as well as the capital ratio attainment and the retained earning growth assumptions. The NCUA should transparently clarify how it intends to deal with legacy assets that remain on the books of corporate credit unions and what impact there will be on natural person credit unions upon the disposition of assets in question. Lastly, we believe that, in the spirit of transparency and fairness, the NCUA should publicly provide its modeling tool and/or assumptions.

Other Areas of Concern

Perpetual Contributed Capital
We support eliminating the current prohibition on a corporate requiring credit unions to contribute capital to obtain membership or receive services. (In other words, a corporate can choose or not to require credit unions to contribute capital in order to receive services from that corporate.) We are of the opinion that leaving this decision to the board and management of a corporate credit union provides appropriate flexibility, and applaud the NCUA for proposing this change.

Caveats: However, we would like to reiterate our concern that many credit unions remain wary of contributing additional capital during these still-unsettled times. This wariness is sharpened in the case of WesCorp, as the degree and duration of NCUA's conservatorship remains undefined. Further, in the event a corporate cannot earn their way into building retained earnings—and, as we indicated earlier, we believe that such an outcome is not likely under the proposed rules—concerns have been raised by credit unions about the possibility of a forced capital contribution. Again, these issues highlight that it is imperative for the NCUA to carefully consider the impact of this proposal in all its aspects –not only each provision on its own, but also the effect each provision will have when put into play with all other provisions in the proposal. When this is done, it becomes apparent to us that the proposal is unworkable in its current form.

Payment of Dividends
The proposal will prohibit an undercapitalized corporate, unless it obtains NCUA's prior written approval, from paying dividends on capital accounts. A blanket prohibition strikes us as counter-intuitive and potentially counter-productive for the future re-capitalization of the corporate credit union system. Capital accounts, as natural person credit unions have painfully learned, are riskier than insured deposits. To balance that higher risk, investing credit unions will be reluctant to contribute capital without the promise of a higher return to compensate for the added risk.

Payment of dividends is a case-by-case decision properly made by the board and management of a corporate credit union in the context of the interest rate environment at a given moment in time. Further, the proposed retained earnings target will serve as a built-in constraint on paying dividends.

The NCUA should not impose a blanket prohibition on undercapitalized corporates from paying dividends on capital accounts. The NCUA should, instead, rely on a retained earnings target—to be developed, presumably, in the next round of proposed rule-making—to serve as a built-in constraint on the payment of dividends.

Concentration Limits

As written, Federal Funds transactions are not specifically excluded from the sector concentration limits. As a result, corporates would have severely limited access to the federal funds market. This will have the harmful effect of reducing the overnight rates that member credit unions receive from their corporate. In addition, it would reduce natural person credit union ability to access or engage in a market-based overnight investment option.

To address this, we recommend that the definition of deposits in 704.6 (d) be amended to include Federal Funds or, alternatively, that the exemptions from sector concentration limits include Federal Funds transactions.

Corporate Credit Union Service Organizations

This section of the proposal adds a very short list of permissible corporate CUSO activities (consisting of brokerage services, investment advisory services, and other categories as approved by the NCUA). We ask the NCUA for clarity in the form of definitions or additional information regarding permissible activities, which are surprisingly scant and inadequately defined in the proposal. Further, it is unclear what would happen regarding corporate CUSOs which currently engage in activities not listed in the proposal. Would these activities be grandfathered? Would the NCUA subject them to an approval process? We believe these issues must be addressed in order to avoid credit union uncertainty or concern regarding services provided by these CUSOs.

The NCUA should clarify definitions or additional information regarding permissible CUSO activities and the grandfathering of current but unlisted CUSO activities.

Credit Ratings

The requirement to obtain multiple ratings may be problematic, as some securities only have one NRSRO rating. This would limit some investment options for corporates and, if this requirement is also implemented in Part 703, natural person credit unions. In any case, it is important to stress that credit ratings are only one of several tools that corporates and natural person credit unions should utilize to evaluate risk.

We urge the NCUA to consider permitting an exception to the multiple rating requirement in situations where there is only one rating and, more broadly, to provide further elaboration in the proposal on what standards, methods, or tools corporates should use in analyzing credit ratings.

Disclosure of Executive and Director Compensation

We believe that this requirement goes well beyond expected and necessary practice. As the NCUA has indicated that this provision mirrors IRS Form 990 with regard to information and access process, we believe it is sensible and desirable for the NCUA to align its compensation disclosure requirements with IRS Form 990 guidelines.

Per IRS practice, we recommend that the definition of "senior executive" in this provision be modified to conform with Form 990 definitions (e.g., "officers," "key employees") and limitations (e.g., only over $150,000 reportable compensation for key employees). Consistent with the Form 990 disclosure requirements, we also advise the NCUA to require compensation disclosures *upon request only* rather than require annual outward reporting of compensation which can be abused by the press to the detriment of the credit union system. Furthermore, corporates should only be required to honor compensation disclosure requests made by bonafide members of the corporate.

We also believe that the NCUA should explore other options for creating a line of defense between corporates and NPCUs.

We thank the NCUA Board for the opportunity to provide our concerns and recommendations regarding this very important rulemaking.

Sincerely,

Dennis J. Huber
President/CEO